

## Section 272 Costs

This exhibit provides additional information regarding the development of Verizon's estimates of the costs that Verizon Global Networks Inc. ("GNI") has incurred and anticipates incurring to comply with the Commission's separate affiliate rules under section 272 of the Act as set forth in the Declaration of Fred Howard, filed in WC Docket No. 01-112 and CC Docket No. 96-149.

For each major type of operating expense, capital expenditure, and depreciation, a determination was made as to the percent of this cost that was incurred strictly because of the section 272 structural separation and nondiscrimination requirements. (See Tables 1 and 2 below.) This percentage was applied to actual costs (including the 2002 budgeted expenses) to determine the "sunk cost" of separation. The same percentages were applied to the business plan that GNI developed in 2002 to determine the anticipated costs for 2003 and beyond that would be incurred solely to meet section 272 separation requirements.

It is important to note that the estimated "incremental cost" from this methodology cannot be directly compared to the actual costs/savings of reintegration because, in many cases, abandonment of sunk investment and complete reintegration of GNI's long distance network and operations with the local exchange company's would not be either possible or cost effective. Without knowing the timeline and the extent of reintegration allowed, it is not possible to arrive at an accurate "bottoms up" view of the costs and/or savings attributable to reintegration.

Using the methodology and conservative assumptions described above, GNI's business costs attributable to structural separation were calculated. The results show that GNI incurred approximately \$195 million in capital costs and \$314 million in expenses, including depreciation on capital, from 1998 through 2002 to meet section 272 requirements. The analysis also shows that GNI will incur an additional \$550 million in expenses from 2003 to 2006 to continue to meet these requirements.

**Table 1. Incremental Operating Expense Driven by Structural Separation**

Expense Category	Description	% of Expenses Driven by Section 272 Requirements
Professional Services	Professional Services consist of the expenses for third-party vendors, primarily to perform field work. If GNI not been restrained by the Commission's rules prohibiting sharing of operating, installation, and maintenance functions with the BOC, this cost could have been avoided almost entirely by using existing BOC field technicians.	95%
Workforce & Employee related expenses	This includes internal GNI technical employees hired to provide OI&M functions. Although GNI startup required employees with skill sets specific to the long distance network architecture, some efficiencies could have been obtained in the absence of the OI&M restriction for job functions that did not require additional staff for the long distance network, including general administration, sourcing functions, and infrastructure for common service (corporate local area network, email, eWeb, training, etc.).	30%
Leased facilities	Without section 272 restrictions, VZ would have built rings instead of leasing facilities (both for use by GNI and by the local exchange company).	15%
Operational Support System (OSS)	Many of the operating support systems that GNI developed separately to comply with the OI&M restriction, such as inventory, provisioning, order management, trouble management, could have been developed through modification of the BOC systems and reused at a fraction of the costs incurred to develop new systems. The operating support system expense category includes software and hardware maintenance, licenses and right-to-use fees, and non-capital software development.	65%
Hub and POP	Absent the section 272 separation requirements, GNI would have collocated with the LEC wherever possible in-region. However, many LEC POP & Hub spaces were or are exhausted. A conservative approach was taken, with 80% of Hub & POP rental expenses driven by 272 requirements.	80%
Network Operations Center (NOC)	The network operations center provides monitoring and control of the long distance network. Although the long distance network requires additional operations, Verizon estimates that some of the incremental costs of the network operations center could have been avoided by using the BOC network operations center to provide these functions.	30%
Other	Miscellaneous (e.g., human resources allocation, Peoplesoft – Accounts Payable System, etc.)	25%
Back Office Provisioning (e.g., Calling Card, Repair)	These back office functions for GNI were driven almost entirely by the OI&M restriction. For instance, Verizon would not have built the Altoona or Worcester operator services facilities if these services could have been obtained from the BOC, and most of the costs of the error management and repair centers could have been avoided by using BOC services.	80%

**Table 2. Incremental Investment And Depreciation Expense<sup>1</sup> Driven by Structural Separation**

<b>Investment/ Depreciation Category</b>	<b>Description</b>	<b>% of Additional Costs Driven by Section 272 Requirements</b>
Hub and POP Equipment	This includes equipment purchased to provide LD service. Some incremental investment could have been avoided by using LEC facilities and equipment.	60%
Administration	80% of capital expenditures, including leasehold improvements, equipment, computers, and software where administrative functions are clearly identifiable (i.e., document server, Lotus notes, administrative PCs, etc.). Most administrative needs would have been served by existing LEC assets.	80%
NOC	A greater percentage of NOC-related capital expenditures were driven by 272 restrictions than expense (e.g. leasehold improvement on separate 272 NOC space).	60%
OSS	Most capital expenditures to establish stand-alone OSSs for GNI could have been avoided by using and expanding existing LEC OSSs.	65%
Laboratory	Most non-OSS LD laboratory equipment and facilities capital expenditures could have been avoided absent the section 272 requirements. Actual capital expenditure for LD lab is less than "greenfield" because of manufacturer contract provisions. Capital expenditure for OSS support in the LD lab mirrors production OSS capital expenditure (65%) because lab test systems for new OSSs would have been required that did not exist in the LEC. Lucent Lab in Holmdel expenses are 100% driven by section 272 requirements (i.e., GNI would not have contracted with Lucent to develop a lab).	65 to 100%

<sup>1</sup> Depreciation was calculated, depending on capital type and number of years depreciated, using straight-line depreciation

### **Estimated Incremental Savings from Reintegration (2003-2006)**

The Commission's Notice of Proposed Rulemaking ("NPRM") in WC Docket No. 02-112 suggests a broad range of scenarios for sunset of the section 272 separate affiliate requirements. Given that each scenario could materially affect when and how reintegration of the section 272 network and organizations would be implemented, Verizon used a general approach to assess sunk costs and anticipated savings resulting from reintegration as percentages of actual and planned expenses. In addition, Verizon assumed for sake of this analysis that the section 272 requirements are removed in all of the states in Verizon's territory in 2003.

If the Commission's section 272 rules were to sunset in 2002, it would not be economic to eliminate all of the "sunk" investments that were made in separate facilities and systems to meet the separate affiliate requirements. However, Verizon conservatively estimates that it could save about \$247 million over the 2003 through 2006 time period by reintegrating operations with the BOC where it was economically advantageous to do so. Approximately \$183 of this amount would be due to elimination of the OI&M restriction.

The incremental costs that are driven by the section 272 requirements cannot be directly compared to the actual costs that would be saved through reintegration. In many cases Verizon has considerable investment sunk in a separate 272-compliant network. For example:

- GNI has long-term lease commitments, and considerable investment in leasehold improvements in those spaces. A "flash cut" to the LEC would not be cost effective.
- The network in the majority of the Verizon East corridor, where the greatest synergies with the LEC are, has already been built. GNI has long-term commitments (leases and RTUs) for fiber and facilities in the Northeast and could not easily move to LEC fiber or facilities.
- OSS suites are in place with considerable software and hardware capital investment (\$130 million).

Nonetheless, considerable costs could be saved by use of LEC workforce and facilities if the structural separations rules were to sunset. For example:

- Force & Professional Services resources could be ramped to achieve pre-separation savings.
- Savings could be realized in POP rent and operating expenses in existing sites in the Verizon East footprint by gradually relocating certain POPs as leases and as collocation agreements lapse.

- Some savings could be realized in this planning window for OSSs by consolidating selected systems.
- Some synergies with LEC could be found in future network build.

It should also be noted that the 2003-2006 savings estimate is based on 2002 Business Planning information, which did not fully take into account currently evolving GNI network expansion plans because the 2003 Business Plan is not yet complete. Additional savings may be realized if section 272 restrictions do not apply to the 2003 plan. The current estimate of potential savings due to re-integration starting in 2003 are shown in Table 3 below.

**Table 3. Incremental Savings Going-Forward (Percentages)**

	2003	2004	2005	2006
Force & Related Expense	10%	20%	30%	30%
Professional Svcs.	40%	80%	95%	95%
Facilities (trunks)	3%	10%	15%	15%
OSS	See below <sup>2</sup>			
Hub/POP Rent	10%	20%	30%	40%
NOC Expenses	10%	20%	30%	30%
Other Expenses	10%	15%	25%	25%
Back Office	30%	60%	80%	80%

### **Operating, Installation and Maintenance (OI&M) Savings**

If the OI&M restriction were eliminated, significant savings could be obtained by consolidating with the LEC the responsibility for the day-to-day provisioning and maintenance of the long distance switch and transport networks in central offices as well as the remote monitoring and provisioning of services from network operations centers. In addition, up-front trouble handling and associated dispatch functions could also be more efficiently managed. The OI&M restrictions affect the expenses in the following categories in the table above: (1) professional services, (2) force and employee related expenses, (3) OSSs, (4) NOC and (5) back office provisioning. Based on this analysis, Verizon estimates that if the OI&M restriction were eliminated, GNI would save approximately \$183 million over the 2003 through 2006 time period by sharing these services with the BOCs.

<sup>2</sup> OSS savings could not be calculated as a percentage of future expenses, as was the case with the other expenses. The incremental savings associated with OSS were based on a case-by-case analysis of OSS cost avoidance/potential savings over the planning period.

**Declaration of**  
**Timothy J. Tardiff**

**September 24, 2002**



## I. INTRODUCTION<sup>1</sup>

1. My name is Timothy J. Tardiff. My business address is One Main Street, Cambridge, MA 02142. I am a Vice President at National Economic Research Associates, Inc. (NERA). I have specialized in telecommunications policy issues for about the last 20 years. My research has included studies of the demand for telephone services, such as local measured service and toll; analysis of the market potential for new telecommunications products and services; assessment of the growing competition for telecommunications services; and evaluation of regulatory frameworks consistent with the growing competitive trends. Most recently, I have participated in interconnection arbitrations, unbundled element proceedings, universal service investigations, and applications by incumbent local exchange carriers for authorization to provide interLATA long-distance pursuant to the Telecommunications Act of 1996, in over 20 states. I attach a copy of my full resume as Attachment A.
2. The purpose of this declaration is to respond to the economic arguments of those opposing Verizon's request that the FCC forbear from enforcing its current prohibition against Bell Operating Companies (BOCs) and their interLATA long-distance affiliates sharing Operating, Installation, and Maintenance (OI&M) functions, with primary focus on the arguments proffered by Dr. Lee Selwyn.<sup>2</sup> Contrary to their assertions, rather than being necessary for competition, the OI&M restrictions are not only unnecessary to ensure that long-distance services are competitive but they also impose extra costs on BOCs that are inconsistent with the intention of the Telecommunications Act that firms in formerly segregated markets enter other markets and provide consumers with the full benefits that their economies of vertical integration can provide. As Verizon has demonstrated in its opening and reply comments, the OI&M prohibition has proven to be costly in practice.

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<sup>1</sup> Some of this work draws upon analysis of similar issues that I have performed in conjunction with Professor Alfred Kahn. See, for example, Public Interest Affidavit of Alfred E. Kahn and Timothy J. Tardiff, CC Docket No. 00-65, January 10, 2000.

<sup>2</sup> Reply Declaration of Lee L. Selwyn in WC Docket No. 02-112, on behalf of AT&T Corporation, August 26, 2002 (Attached to AT&T's Opposition in this proceeding).

This demonstrates the inefficiencies that are imposed when carriers are prevented from offering a full range of services in complementary markets as was intended in the Telecommunications Act of 1996.

3. As I describe in detail below, actual experience with BOCs offering services on a vertically integrated basis in competition with firms that obtain inputs from them has shown that competition has been successful without such costly OI&M requirements. The most direct example is the intraLATA toll market, where competing carriers have been able to obtain increasing shares of the market despite the fact that the BOCs started with 100 percent of the market and have been allowed to continue providing these services on an unseparated basis with no OI&M restriction. Similarly, past fears that allowing the BOCs to compete in markets such as customer premises equipment and information services on an unseparated basis would allow them to drive out competition have proven to be false – the BOCs have only small shares of these markets, which are highly competitive despite the fact that competing firms must obtain interconnection to the BOC facilities. In addition, the BOCs provide inside wiring maintenance using a combined workforce in much the same way that they would perform OI&M services for their interLATA services without the OI&M restriction, and yet the market is highly competitive. The Commission has successfully used cost accounting rules and rate imputation to protect competition in these markets, and there is no reason to believe that similar safeguards would not be sufficient in the interLATA market.
4. The OI&M restriction is a redundant safeguard that actually harms competition by handicapping the BOCs and by ultimately passing along the costs of this restriction to consumers. The harm to competition and consumers from maintaining this unnecessary requirement is exacerbated by the fact that not only do the BOCs' long-distance and other services compete with services provided by carriers that choose to obtain inputs from the BOCs, but ever increasingly and for very lucrative customers, BOCs must compete with carriers that can provide vertically-integrated services that capture their own scope economies without any need to obtain inputs from the BOCs.

5. In contrast to both the intent and vision of the Telecommunications Act and the subsequent reality that firms in formerly separate markets would enter into and compete against the incumbent providers in these markets, Dr. Selwyn instead attempts to turn back the clock, not merely to 1996, but all the way back to 1984, when the divestiture of AT&T legally separated long-distance and local exchange markets, as shown by his assertion (at p. 4) that relaxation of current separate subsidiary requirements would recreate the conditions that led to the break-up of the Bell System of 1984. Because of the changes in technology, law, regulation, and competition itself, all of which were accelerated by the 1996 Telecommunications Act, 2002 is not 1984. In particular, there is no likelihood that history will repeat itself if regulations such as the OI&M restriction were not applied. More importantly, efficient competition requires that they be removed to fulfill the objectives of the 1996 Act.

## II. ECONOMIC IMPORTANCE OF SCOPE (VERTICAL INTEGRATION) ECONOMIES: THEORY AND EXPERIENCE

6. Dr. Selwyn and others argue that realization of more of Verizon's potential economies of scope in serving local exchange and long-distance customers would provide an unfair advantage over their competitors. They are mistaken, for two reasons, one of principle and one of fact – the increasing convergence of markets that I described in the introduction. As for the former, competitive advantages arising out of economies of scope are precisely the kind of efficiency advantages that we expect and *want* to prevail under competition. Integration is fundamentally a *competitive* phenomenon, and the efficiency advantages it confers on the integrated firms are socially beneficent. The first fundamental competitive principle of freedom of entry means, first and foremost under conditions of real-world competition, freedom of existing firms to integrate into other operations or markets that they think they have special qualifications to serve.<sup>3</sup> Competition by integration of existing

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<sup>3</sup> In a book devoted to the proposition that vigorous enforcement of the antitrust laws is necessary for the preservation of fair competition, Professor Alfred Kahn began the chapter "Business Integration and Monopoly" with the proposition:

competition requires ... that business units be free, ordinarily, to take on new products, new functions, or enter new markets—in short, to integrate.

firms into related markets is most likely to be socially productive precisely because it represents an attempt to achieve the benefits of economies of scope, the manifestation of which is the ability of a firm to supply a number of products or services in combination at lower costs than if it were to supply them separately. The source of such economies is the possibility – indeed, the pervasive phenomenon – of existing firms having special capabilities of their physical plant, their managerial or labor forces, technological or marketing skills or reputations taking on the provision of additional products or services at incremental costs lower than the costs of setting up systems to supply those additional services separately.<sup>4</sup>

7. In raising the specter of the long-distance market returning to pre-divestiture conditions,<sup>5</sup> Dr. Selwyn either ignores more recent experience that belies his pessimistic assessment and/or draws the wrong conclusion from history that is most apt, such as intraLATA toll competition. Indeed, there has accumulated, over the period since divestiture, a great deal of actual experience with competition between the BOCs – and other incumbent local exchange carriers (“ILECs”) – on the one side, and rivals dependent on access to their facilities. An ounce of such actual experience is surely weightier than a pound of speculation about possible misdeeds and/or, predictions of re-monopolization. Assertions about the theoretical inadequacies of regulatory safeguards against predation, cross-subsidy and discriminatory treatment of competitors simply ignore this historical evidence. In practice, competition by non-vertically integrated firms with BOC “bottleneck monopolies” has already succeeded in other telecommunications markets that are at least as susceptible

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Joel B. Dirlam and Alfred E. Kahn, *Fair Competition: The Law and Economics of Antitrust Policy*, Ithaca, NY: Cornell University Press, 1954 (reprinted by Greenwood Press, 1970).

<sup>4</sup> See the similar observations in Melvin G. de Chazeau and Alfred E. Kahn, *Integration and Competition in the Petroleum Industry*, New Haven: Yale University Press, 1959, p. 261 and in Alfred E. Kahn, *The Economics of Regulation*, Vol. 2, pp. 260-261.

<sup>5</sup> Dr. Selwyn (p. 9) seems to believe that Verizon has been “too successful” in attracting customers to its long-distance services. To the contrary, as Professor Kahn and I anticipated in our affidavits in support of SBC’s entry into interLATA long-distance (see for example, Kahn and Tardiff, *op. cit.*), this success is the result of the BOCs’ economies that allow it to offer quality services that benefit consumers (e.g., its economies of scope and strong brand identity) as well as the fact that BOCs are offering attractive alternatives to customers (such as smaller-volume residential customers) who had previously not experienced the full benefits of toll competition.

to anti-competitive tactics as the interLATA market<sup>6</sup> -- intraLATA long-distance; geographic corridors in which the BOCs have been permitted to offer interLATA service; voice messaging services (VMS) and other information services; and customer premises equipment (CPE) and inside wiring.<sup>7</sup> The most cogent lessons from this experience are as follows.

### 1. IntraLATA toll

8. Dr. Selwyn correctly observes (pp. 25-26) that ILECs face fewer regulatory restrictions in the provision of intraLATA toll services than they encounter after obtaining 271 approval (even in the event that the OI&M prohibition were relieved). Accordingly, if Dr. Selwyn's assertions about the threat of re-monopolization had any validity, one would expect that intraLATA competition would have been a non-starter. In fact, all states with multiple LATAs permit intraLATA toll competition; and in none of them have the ILECs been required to divest themselves of their toll businesses or even to create separate subsidiaries. When the interexchange carriers (IXCs) entered these markets, they (i) started with small initial market shares, (ii) had few facilities within the LATA, so that they were heavily dependent on the LECs for access to subscribers, (iii) did not have complete dialing parity,

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<sup>6</sup> There are no requirements that the BOCs offer these services through separate affiliates or not share OI&M services between these product lines. This demonstrates that the existing safeguards such as equal access and imputation, which apply when the BOCs provide these services, are by themselves sufficient for the BOCs' offering of interLATA services.

<sup>7</sup> International experience lends further support to the argument that regulatory safeguards other than separate affiliate requirements are sufficient. While the United States was clearly the leader in opening long-distance markets to competition, it has been alone in requiring divestiture and quarantine. And yet, despite their having removed their barriers to entry into those markets well after the United States had done so and despite their having permitted the providers of essential local exchange services to continue to offer the newly competitive services, toll competition has made substantial progress in other countries. For example, until a recent intensification of price competition restored some of their losses, the incumbents in Canada had lost more market share since competition was authorized in 1992 than occurred in the United States over the comparable period after 1984. Similarly, three facilities-based carriers have captured over 45 percent of the Japanese long-distance market since 1987, despite the fact that the incumbent NTT remains vertically integrated. Willie Grieve and Stanford L. Levin, "Telecom Competition in Canada and the U.S.: The Tortoise and the Hare," *Selected Papers from the 25<sup>th</sup> Annual Telecommunications Policy Research Conference*, Alexandria, VA, September 27-29, 1997. Likewise, Spiller and Cardilli report that facilities-based local competition has progressed at a healthy pace in the smaller countries they examined (Australia, Chile, Guatemala and New Zealand), even though none of these countries has the extensive unbundling requirements for an indefinite duration that prevail in the United States or has prevented incumbents from vertically integrating. Pablo T. Spiller and Carlo G. Cardilli, "The Frontier of Telecommunications Deregulation: Small Countries Leading the Pack," *The Journal of Economic Perspectives*, Vol. 11 (1997), pp. 127-138.

and (iv) had to compete against inexpensive local calling within the LATA and overcome initial ignorance on the part of subscribers that they now had a choice of providers. Even under these circumstances, LECs are losing significant amounts of market share, particularly for large business customers that combine interLATA and intraLATA traffic on the same dedicated facilities. Despite the fact that dialing parity was not universally required before 1999,<sup>8</sup> the IXC's had already captured 22 percent of that market nationwide by 1995.<sup>9</sup> This amount of market share loss by incumbents is comparable to AT&T's in the interLATA market by 1988 (four years after divestiture) and is all the more remarkable in light of the fact that intraLATA toll competition was not even authorized in two of the states with the largest amounts of intraLATA traffic, which account for 46 percent of all such calling (California and New Jersey), until 1995. Since 1995, the incumbents' market share appears to have fallen even further – to a level substantially lower than AT&T's in interstate long-distance when it was accorded non-dominant status.<sup>10</sup> The success of competition for long distance intraLATA business is strong evidence that the hypothetical dangers of discriminatory treatment of BOC affiliates and their competitors are in fact adequately precluded by other regulatory safeguards, such as equal access and imputation. Neither structural separation in general nor an OI&M restriction in particular were necessary to allow competition to flourish in this market.

## **2. InterLATA corridor traffic**

9. BOCs had routinely provided interLATA services since divestiture under exceptions to the AT&T consent decree, the notable example of which is Bell Atlantic's interLATA service between New York and New Jersey and between Philadelphia and New Jersey. In a

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<sup>8</sup> The Act mandated dialing parity in all areas as of February 1999. Section 271(e)(2).

<sup>9</sup> Affidavit of Professor Marius Schwartz, filed on behalf of the DOJ in response to Southwestern Bell's Oklahoma petition (CC Docket No. 97-121), May 14, 1997, p. 11, fn. 4.

<sup>10</sup> According to ARMIS data, Report 43-08, between 1995 and 2001, the ILECs' intraLATA toll volumes decreased substantially. If the 43 percent decrease in intraLATA toll volume per line represents market share loss from the 78 percent estimated by Schwartz, then the ILEC share by the end of 2001 was about 45 percent ( $0.78 \times 0.57$ )—noticeably lower than AT&T's share at the time the FCC ruled that it was no longer dominant. Verizon's decrease in intraLATA toll volumes was even larger – 47 percent in the former Bell Atlantic territories and 54 percent overall.

testimonial to the effectiveness and persistence of competition, the FCC *removed* these services from price cap regulation:

As a result of the competition that has developed since the consent decree and the Telecommunications Act of 1996, price cap LECs may now be non-dominant in the provision of corridor and interstate intraLATA toll services, particularly in light of the availability of inter- and intraLATA dialing parity. Although the record in this proceeding is insufficient for us to conduct the analysis outlined in the *Dominant/Non-Dominant Order*, we do conclude that developments in the markets for interexchange services make it unlikely that price cap LECs will be able to exploit over a sustained period any individual market power in their provision of corridor and interstate interLATA toll services.<sup>11</sup>

This occurred despite the fact that the Bell Atlantic was allowed to provide these interLATA services without using a separate affiliate, without using separate facilities, and without using separate OI&M services. The Commission successfully relied on the requirements for equal access and imputation of the same access charges to these services that Bell Atlantic assessed on non-affiliated providers of interLATA services.

### 3. Information Services (e.g., Voice Messaging Service (VMS))

10. In the Computer III proceeding, the Commission eliminated the requirement that the LEC's provide information services, such as voice messaging services, through separate affiliates.<sup>12</sup> The Commission found that the separate affiliate requirement had undermined the incentive for the LEC's to invest in these services, and that separate affiliates were not needed to protect competition.<sup>13</sup> This decision has proven to be correct, as consumers subsequently benefited from an expansion of information services by the LECs while

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<sup>11</sup> Federal Communications Commission, Fifth Report and Order and Further Notice of Proposed Rulemaking, In the Matter of Access Charge Reform, CC Docket No. 96-262, Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers, CCB/CPD File No. 98-63, Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, CC Docket No. 98-157, August 27, 1999, par. 53. The FCC goes on to list as factors ensuring the survivability of competition the ability of the major IXCs to expand capacity and their strong brand identities.

<sup>12</sup> Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), Report and Order, 104 F.C.C.2d 958 (1986).

<sup>13</sup> In addition, the FCC has ruled that the Open Network Architecture (ONA) safeguards are sufficient to deter conduct that has been alleged to be anti-competitive in the past. (Bell Operating Companies Joint Petition for Waiver of Computer II Rules, Order, 10 FCC Rcd. 13764, 1995, par. 32.)

competition has continued to grow unabated. Since the BOCs and GTE began offering VMS, consumers have benefited in at least two ways. First, the monthly charge has dropped from \$30 in 1990 to \$5-\$15 in 1995.<sup>14</sup> Second, the LECs began offering VMS to residential and small business customers, a hitherto untapped market segment. In five years, the BOCs' participation in this market increased from zero to over six million subscriptions, yet other competitors have thrived, and the BOCs and GTE together account for just over 15 percent of the total revenues nationally.<sup>15</sup> Similarly, there are hundreds of non-affiliated Internet service providers (ISPs), which need to connect to the BOCs local networks, and the ISPs affiliated with BOCs have only a small share of this activity. If AT&T's claims were true, the ability of the BOCs to offer these services on an integrated basis would have been the death knell for competition in the information services market. Instead, just the opposite occurred. Despite the fact that information services providers use the BOCs for access to end users, there is no evidence that competition has been impeded by allowing the BOCs to offer these services on an integrated basis.

#### **4. Customer premises equipment and inside wiring**

11. Though barred from manufacturing until 1996, Verizon and the other BOCs have been permitted to provide CPE on an unseparated basis. As in the case of interLATA toll, competitors of the BOC must interconnect with the incumbent's network – typically in the form of connecting to a BOC-provided access line. There is no evidence – nor have there, to our knowledge, been even assertions – that they have attempted, by exercising their control over interconnection, to exclude competitors,<sup>16</sup> let alone succeeded. Indeed, the collective share of local telephone companies in CPE distribution has been small, on the order of 15 percent.<sup>17</sup> Similarly, in recognition of its competitive nature, the Commission

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<sup>14</sup> J.A. Hausman and T.J. Tardiff, "Benefits and Costs of Vertical Integration of Basic and Enhanced Telecommunications Services," prepared for filing with the Federal Communications Commission, Computer III Further Remand Proceedings, CC Docket No. 95-20, on behalf of Bell Atlantic, Bell South, NYNEX, Pacific Bell, Southwestern Bell, and U S West, April 6, 1995.

<sup>15</sup> *Ibid.*, pp. 5, 10.

<sup>16</sup> NERA staff reviewed complaints filed against the BOCs with the FCC between 1985 and 1991 and found none about the offering or interconnection of CPE.

<sup>17</sup> North American Telecommunications Association, *1995 Telecommunications Market Review and Forecast*,

has allowed the BOCs to install and maintain inside wiring, which connects directly with their networks, on a deregulated basis for years. There are no structural separation safeguards with regard to either the provision of CPE or inside wiring installation and maintenance. The BOCs are allowed to enjoy the efficiencies of providing these services on an integrated basis, using the same OI&M workforce that supports the wireline network, and to use accounting procedures to allocate costs between these non-regulated services and their regulated network services. Again, the success of nonstructural safeguards in these markets is ample proof that Dr. Selwyn's theory of re-monopolization of the long distance market in the absence of structural separations is far-fetched.

12. The assertion of Dr. Selwyn and other proponents of maintaining restrictions on BOCs that existing restrictions should be removed only when BOCs are devoid of market power in the provision of local exchange service badly misses the point. In addition to the fact that experience indicates that competition can thrive even when competitors require essential inputs from BOCs, the growing competition from both intra- and intermodal competitors renders discrimination and other anticompetitive acts in the provision of network access increasingly counterproductive – in the light of competitive inroads and the concomitant loss of volumes incumbents have recently experienced, such actions would hasten such losses in the future. Further, because unnecessary regulatory restrictions increase the BOCs' costs of providing service and thus deny consumers the economic benefits of efficient supply, undue maintenance of such restrictions is inconsistent with the objectives of the Act to facilitate competition and deregulation. Indeed, the Act properly called for local exchange markets to be open to competition (through satisfaction of the 14-point competitive check-list)<sup>18</sup> and not for any particular market share or market power test to be invoked. Similarly, Section 272 properly calls for sunset of separate subsidiary

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Sections III-1 to III-2.

<sup>18</sup> In light of the historical success of competition between vertically integrated ILECs and competitors using inputs from them, I have argued elsewhere (e.g., in the public interest affidavit with Professor Alfred Kahn cited in note 9) that the market-opening provisions of Section 271 makes most sense when viewed as an incentive for BOCs to open their local markets, rather than as a necessary condition for successful interLATA toll competition.

requirements without reference to any market share/market power metrics applied to local exchange services.

### III. REPLY TO SPECIFIC ASSERTIONS

13. Dr. Selwyn makes three specific claims regarding the removal of the shared OI&M prohibition: (1) that removal would provide Verizon with a cost advantage, (2) that removal of the restriction is unnecessary because Verizon's long-distance affiliate is on exactly the same footing as IXCs that obtain access services from it, and (3) that separate subsidiary requirements (including the OI&M prohibition) are necessary because the other safeguards that would continue to prevail, in particular, price cap regulation and the imputation requirements of Section 272, are insufficient to deter anticompetitive conduct.
14. With respect to the cost advantage issue, as a matter of principle, removing unnecessary restrictions will improve Verizon's position vis-à-vis its competitors. But, as I described earlier, allowing all competitors to fully use scope economies and compete on the merits is entirely consistent with how competition is supposed to work as well as the objectives of the Act. The results of such competition (e.g., the resulting structure of the market, who will enter and be successful, and what products will be offered) is difficult to predict a priori (after all, that's why we have markets in the first instance), but the end result is greater benefits for consumers in the form of more choice, richer product offerings, lower prices, and more innovation, as all firms face the proper economic incentives to invest in their networks. Indeed, Dr. Selwyn's discussion seems to be somewhat contradictory on this issue. On the one hand, he seems dubious that cost savings are as large as Verizon reports.<sup>19</sup> If such savings are as immaterial as Dr. Selwyn suggests, it hard to understand his concerns about advantages that would lead to an eventual re-monopolization of toll services. On the other hand, to deny Verizon the opportunity to organize efficiently would inhibit the attainment of the full benefits from vigorous competition that the Act envisioned.
15. With respect to Dr. Selwyn's assertion the current separate affiliate restriction places Verizon and its competitors on equal footing because non-BOC providers rely upon BOC facilities in all but rare instances, I note that he focuses on the number of customer

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<sup>19</sup> Attached to Verizon's reply is additional information to support its cost savings estimates

*locations* served by non-BOC facilities in making his claim. This focus ignores the fact that competitive local exchange carriers ("CLECs") (including AT&T) have concentrated their facilities-based competitive responses on the most lucrative of these locations – a relatively small number that account for a disproportionate share of demand. And it is in the service to these customers (for which AT&T and other carriers can provide integrated end-to-end service) that Verizon reports that the OI&M restriction is especially onerous. In fact, the *UNE Fact Report*<sup>20</sup> shows that CLECs provide between 11 and 19 million business lines using their own loop and switching facilities and these account for 20 to 30 percent of *all* business lines in BOC territories (excluding the Verizon's former GTE territories). Among large business customers concentrated in urban areas, the CLECs' share is likely much higher. Consequently, contrary to Dr. Selwyn's claim, non-BOC carriers *can* provide local and long distance services on an integrated basis, and competition on the merits (e.g., without unnecessary and counterproductive restrictions such as the OI&M prohibition) would provide them with the ability and incentive to grow their offerings of integrated services.

16. In fact, Dr. Selwyn's client – AT&T – is a major and growing supplier of facilities-based local services to both business and residential customers. Its recent annual reports and financial filings clearly indicate the extent of its facilities-based presence.

- As of the second quarter of this year, it had 1.22 million cable telephony customers (16 percent penetration in the areas it serves), up almost 50 percent from the previous year.<sup>21</sup>

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<sup>20</sup> *UNE Fact Report 2002*, prepared for and submitted by BellSouth, SBC, Qwest, and Verizon to the Federal Communications Commission, In the Matter of Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers (CC Docket No. 01-338), Implementation of the Local Competition Provisions of the Telecommunications Act of 1996 (CC Docket No. 96-98), and Deployment of Wireline Services Offering Advanced Telecommunications Capability (CC Docket No. 98-147), April 2002.

<sup>21</sup> AT&T, Earnings Commentary, Quarterly Update—Second Quarter 2002, July 23, 2002. Total cable telephony volume exceeds 2 million subscribers and analysts estimate that within 10 years, most households passed by cable will be able to get phone service. The success of cable providers in gaining subscribers is due in part to their ability to package television, Internet, and phone service (an example of their scope economies). In order to compete effectively, BOCs must respond by offering similar bundles of services. See, for example, Peter Grant, "More Consumers Answer Cable's Call on Phone Service," *Wall Street Journal*, September 5, 2002.

- It has 3.3 million business lines—28 percent more than in the previous year. In describing how these lines are provided, AT&T's 2001 10K report described its local networks in 80 cities, which consist of 110 local switches, 17,000 route miles of fiber and access to 6,300 buildings.<sup>22</sup>

17. As Verizon described in its opening comments in WC Docket No. 02-112, not only have new entrants gained substantial volumes in the local exchange market by availing themselves of the unbundling and resale provisions of the Telecommunications Act, Verizon (and other ILECs) face competition from CLECs that serve customers with their own facilities *and* from intermodal (and fully integrated) competitors such as wireless carriers and cable television companies that offer telephone and high-capacity broadband services<sup>23</sup> over upgraded facilities. As a result of this competition (and other factors such as the overall state of the economy), Verizon and other BOCs have experienced decreases in access lines and traffic volumes.<sup>24</sup>
18. Dr. Selwyn (at p. 14) presents one fact from the FCC's most recent assessment of wireless competition – that incumbents have an interest in wireless companies that serve 42 percent of wireless phones – to argue that the BOCs have not faced real competitive loss from wireless competition. That same report examined wireless competition on a number of dimensions, e.g., customer choice, demand growth, price competition, and concluded that there is “a high level of competition for most customers.”<sup>25</sup> This competition, in which the

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<sup>22</sup> In contrast to its description of how it supplied local service to its consumer (residential) long-distance customers (through UNE-P), AT&T's reports make no mention of the use of ILEC-supplied inputs in supplying local exchange services to businesses.

<sup>23</sup> As Verizon described in its opening comments, not only do the broadband services of other providers (e.g., cable modems) constitute a form of vertically-integrated competition, they also illustrate the fact that distinctions that may have made sense at one time can become meaningless as markets converge. For example, the distinction between intraLATA and interLATA communications for Internet telephony services provided over broadband facilities may well be meaningless, and attempts to separate costs according to such distinctions is at best inefficiently costly, and perhaps even impossible.

<sup>24</sup> According to ARMIS data, Report 43-08, between 2000 and 2001, ILECs' switched access lines declined by five percent (from 175.0 million to 166.8 million) and Verizon's decreased by over two percent (from 61.7 million to 60.3 million).

<sup>25</sup> Federal Communications Commission, In the Matter of Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services, Seventh Report, July 3, 2002, p. 19.

wireless offerings of ILEC-affiliated companies are competing head-to-head,<sup>26</sup> has produced lower prices and greater choice and at the end of 2001, about 60 percent of all US households included wireless users.<sup>27</sup> The FCC also described how wireless offerings are competing directly with the local and long-distance services of incumbent providers, resulting in access line losses for the former and reductions in traffic volumes for the latter.

19. The impact of intermodal competition on the industry has also been acknowledged by Dr. Selwyn's client—AT&T. In describing the competitive environment for its long-distance offerings, AT&T's 10K Annual Report for 2001 noted:

In addition, long-distance telecommunications providers have been facing competition from non-traditional sources, including as a result of technological substitutions, such as Internet telephony, high-speed cable Internet service, e-mail, and wireless services...AT&T currently faces significant competition and expects the level of competition will continue to increase. As competitive, regulatory, and technology changes occur, including those occasioned by the Telecommunications Act, AT&T anticipates that new and different competitors will enter and expand their position in communications services markets. These will include regional phone company competitors in existing states and new states plus entrants from other segments of the communications and information services industry or global competitors seeking to expand their market opportunities. Many of these new competitors are likely to enter with a strong market presence, well-recognized names and pre-existing direct customer relationships.<sup>28</sup>

20. Of course, AT&T has described what from its perspective is the same convergence of markets Verizon identified in noting the significant inroads intra-modal and intermodal competition have made in its services. This is precisely what the Telecommunications Act envisioned and intended to foster. Although, even if there were no vertically integrated intermodal competitors, competitive safeguards such as non-discrimination and imputation

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<sup>26</sup> Consequently, Dr. Selwyn's calculation of collective BOC national market share is not indicative of the competition that a BOC affiliate in its home region faces from other wireless providers, because a large part of this "BOC" market share includes wireless carriers that a BOC owns outside of its own region, where it obviously has no ability to control any essential inputs to other carriers. For example, customers in Verizon's territories can choose among Verizon wireless, Cingular (an SBC affiliate) as well as several other providers that are not affiliated with BOCs, e.g., AT&T wireless. Indeed, because BOC-affiliated carriers from other regions are presumably most knowledgeable about any real risks of anti-competitive conduct directed at them by the incumbent wireline carriers, this head-to-head competition is perhaps the best evidence that participation by BOCs in the wireless business does not impede competition.

<sup>27</sup> *Ibid*, p. 32.

requirements are sufficient without the OI&M prohibition, the presence of intermodal competitors exacerbates the competitive harm of maintaining this unnecessary prohibition. Indeed, the proper regulatory response to these developments is to allow all competitors to use their scope economies in providing services across formerly segregated markets, so that the objective of the Act "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies"<sup>29</sup> can be realized. Unnecessary restrictions on particular competitors, including the OI&M prohibition, are inconsistent with the primary purpose of the Act.

21. Turning to Dr. Selwyn's claims that price cap and imputation safeguards would be ineffective without structural separation and the OI&M restriction, I first note that his claim that the BOCs will cross-subsidize their interLATA services without such restrictions hinges on the (incorrect) proposition that the BOCs have any ability to impose above-cost access charges on other carriers. This proposition is incorrect for a number of reasons. First, the current level of federal access charges is a result of the CALLS settlement (of which AT&T was a participant) and not a unilateral action by Verizon or any ILEC. Indeed, these charges are very low (i.e., the margin above cost is small) and constitute an historically small share of the total cost of long-distance service – originating and terminating access charges on an interLATA calls for carriers subject to federal price cap regulation average about 1.4 cents per conversation minute, which is less than one-sixth of the average revenue per minute of about 9 cents.<sup>30</sup> These carrier access prices continue to be regulated and therefore cannot be increased by the ILECs. Accordingly, the proper focus is not cost allocation, but whether competition is capable of being harmed, given the regulated level of access charges. And the answer is clearly no—as Professor Kahn<sup>31</sup> has

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<sup>28</sup> AT&T 2001 10K, p. 35

<sup>29</sup> See Telecommunications Act of 1996, preamble.

<sup>30</sup> Federal Communications Commission, *Trends in Telephone Service*, May 2002, Tables 1.4 and 14.3. Current access charge levels are less than 10 percent of what they were when access charges were established immediately after divestiture.

<sup>31</sup> See, for example, Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation*, Michigan State University, The Institute of Public Utilities and Network Industries, 1998, pp. 109-113.

pointed out in numerous contexts, imputation provides all efficient firms sufficient ability to compete. Since imputation of access charges under section 272(e)(3) of the Act applies both before and after sunset of the separate affiliate requirements, those requirements in general, and the OI&M restriction in particular, are redundant safeguards that add uneconomic costs without any regulatory benefits.<sup>32</sup>

22. Dr. Selwyn's dismissal (at pp. 37-38) of the imputation requirement as being economically meaningless to the BOC is incorrect. When faced with the decision to offer long-distance at a particular price, a rational ILEC will ask itself whether it can earn more profits by offering the service itself than by selling access to competitors that would serve the volumes in question. The only circumstances under which a rational firm would sacrifice greater profits from offering access (i.e., engage in a price squeeze),<sup>33</sup> would be if it believed it could drive its rivals out of the market and recoup the forgone profits with higher prices subsequent to that exit. Given the competitiveness of interLATA long-distance, such predatory behavior could not succeed.<sup>34</sup>
23. The same considerations demonstrate why his dismissal of price caps is incorrect. In view of the facts that both retail and access prices are capped by federal and state regulation, a rational firm would reduce the price of its interLATA toll service only if it could earn more profits from offering this service than selling access to competitors. Because price caps

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<sup>32</sup> See, for example, Dennis L. Weisman, "The Law and Economics of Price Floors in Regulated Industries," *Antitrust Bulletin*, Vol. 47, 2002, pp. 107-131.

<sup>33</sup> Dr. Selwyn (at fn. 70) makes the puzzling claim that Hausman, et al.'s suggestion that BOCs with 271 authorization take into account their economies of vertical integration when pricing their services implies that they ignore imputation requirements. First of all, Dr. Selwyn's analysis is internally inconsistent—he simultaneously disputes the validity of Hausman's findings that prices are lower in states with 271 authority, yet he credits the explanation ("double marginalization") of why prices are lower. More fundamentally, the fact that vertical integration allows a firm to charge lower prices to end users does not demonstrate that such prices fail an imputation requirement and Dr. Selwyn offers no such demonstration. If fact, if the BOC could earn more profit by selling access than offering retail toll, it would be rational to do so and such a decision would imply that imputation requirements have been satisfied.

<sup>34</sup> Dr. Selwyn (at p. 10) attempts to link a price increase by SBC to eventual monopolization of long-distance by BOCs. The fact that a new entrant adjusts its initial prices as it gains market experience is not unusual. Further, it is not indicative of predatory behavior that would lead to monopolization, because in that instance, price increases occur *after* rivals have left the market. Further, in light of Dr. Selwyn's insinuation that the alleged price increases are competitively problematic, it is curious that he later asserts that BOC long-distance prices are too low, because imputation requirements have been ignored.

preclude the possibility of recouping losses with higher prices from "captive" customers, the issue of how internal "transfer prices" are recorded is irrelevant.<sup>35</sup>

24. Access charges are directly regulated by the FCC and the several states and are subject to imputation requirements not only in the Federal jurisdiction and in most of the states but under the overriding authority of the Act itself. Moreover, as of 1999, thirty-six (36) states and the District of Columbia as well as the FCC had substituted price caps for traditional cost-plus, rate base/rate of return regulation.<sup>36</sup> Price caps represent an improvement over the traditional methods of regulation in two ways. First, they supply stronger incentives on the part of the regulated firms to improve their efficiency, since they retain the benefits of any such cost reductions – subject of course to reexamination of the price cap formulas. Second, and more directly pertinent in the present context, they can eliminate the incentive of the regulated firms to engage in predation or otherwise cross-subsidize competitive services because, by breaking the link between the firms' overall profits and regulated rates, they eliminate – to the extent the price cap regimes are pure<sup>37</sup> -- the opportunity to recover

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<sup>35</sup> Dr. Selwyn even goes so far as to suggest that rate-of-return regulation for regulated retail and access services (presumably the competitive toll service would be unregulated) would be superior to price caps. In fact, if ILECs managed to gain approval for an increase in carrier access charges, that higher price would be factored into the decision on whether a particular price for toll would be profitable relative to selling access to competitors and the irrationality of a price squeeze would still remain.

<sup>36</sup> *State Telephone Regulation Report*, August 20 and September 3, 1999.

<sup>37</sup> That is to say, to the extent that they do not provide for sharing between companies and ratepayers of excesses or inadequacies of profits and are not promptly "corrected" to eliminate excessive profits or losses, either retroactively or prospectively. The majority of the plans are indeed "pure" in the former sense: of the (at least) 29 states we counted as having adopted some form of price cap regulation as of June 1996, only two had provisions for sharing either surpluses or deficiencies in achieved rates of return with ratepayers; and one of them, California, has suspended that sharing provision and the other, New Jersey, has just eliminated sharing.

As for "purity" in the sense of a complete abandonment of tests of the price cap formulas or freezes against achieved rates of return, no plan to our knowledge rigidly excluded the possibility of such a test—in this sense, no plan was "pure." On the other hand, our survey, as of June 1996, of price cap plans adopted in the previous three years disclosed that the commissions were typically planning on an approximately five year interval before subjecting the formulas to review. The periods (in years) were: Illinois—3; Iowa—4; Kansas—5; Kentucky—at least 4; Maine—5; Massachusetts—at least 6; Michigan—2; New Jersey—6; North Carolina—5; Ohio—6; Pennsylvania—5, South Carolina—1; and Wisconsin—6.

Finally, competitive forces are growing sufficiently strong so that both federal (e.g., the FCC's mechanism for special access price flexibility) and state regulators are freeing services from price cap regulation. (See, for example, New Jersey Board Of Public Utilities, Board Meeting in Docket No. T001020095 – In the Matter of the Application of Verizon-New Jersey, Inc. for Approval (i) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing, June 19, 2002; Massachusetts Department of Telecommunications and Energy, DTE 01-31-

all of those costs or losses from monopoly customers. Unsurprisingly, state regulators and Federal courts have ruled that price cap regulation can be an effective safeguard against cross-subsidization and other such anti-competitive behavior.<sup>38</sup>

#### IV. CONCLUSIONS

25. Despite Dr. Selwyn's claims to the contrary, the pre-divestiture long distance market is a relic of the past with no prospects of returning. Developments in technology, law, regulation, as well considerable successful experience with vertically-integrated BOCs competing with companies that acquire inputs from them demonstrate that the non-discrimination and imputation safeguards that will remain after interim separation requirements such as the OI&M expire are sufficient. Maintenance of unnecessary requirements is not only superfluous in meeting the objective of safeguarding competition,

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Phase I, Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts, May 8, 2002; and New York Public Service Commission, Order Instituting Verizon Incentive Plan, Cases 00-C-1945 and 98-C-1357, February 27, 2002.)

<sup>38</sup> For example:

[A] well designed price cap plan insulates ratepayers from investment risk and subsidization of new ventures. Massachusetts Department of Public Utilities, *NYNEX Price Cap*, D.P.U. 94-50 (May 12, 1995), p. 121.

A properly designed alternative regulation plan affords the opportunity not only for the Company to transition itself to a more competitive environment, but allows this Commission to implement safeguards and allocate risk in a fashion that protects the interests of all interested parties. Illinois Commerce Commission, 92-0448/93-0239 Consol. (October 11, 1994), p. 19.

We find attractive many aspects of a pure price cap model for establishing revenue levels .... The utility and its shareholders would be completely at risk for their operational decisions, and incentives to cross-subsidize more competitive activities with monopoly profits from basic services would be greatly reduced. California Public Service Commission, Decision 89-10-031, In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers (October 12, 1989), at 172-173.

[T]he FCC has taken specific affirmative steps designed to deter and detect cross-subsidization by introducing price caps as well as further strengthening its cost accounting rules. We conclude that with the implementation of these measures, the FCC ... has demonstrated that the BOCs' incentive and ability to cross-subsidize will be significantly reduced. *California v. FCC*, No. 92-70083 and Consolidated Cases, 39 F.3d 919 (9<sup>th</sup> Cir. 1994) ("California III") at 926-927.

[Price cap regulation] reduces any BOC's ability to shift costs from unregulated to regulated activities, because the increase in costs for the regulated activity does not automatically cause an increase in the legal rate ceiling. *United States v. Western Elec. Co.*, 301 U.S. App. D.C. 268, 993 F.2d 1572 (D.C. Cir.), cert. Denied, 114 S. Ct. 487 (1993) at 1580.

but positively harmful in increasing the costs of production of firms subject to them, thus denying consumers the full benefits of competition.

26. The benefits to consumers from firms utilizing their scope economies from vertically integrating in order to offer attractive product bundles (one-stop shopping) and the harm to competition from impeding the use of such economies become increasingly important with the convergence of formerly separated markets. Consistent with the objectives of the Telecommunications Act, firms are making large investments in their facilities in order to provide voice, data, Internet, and video services in a way in which old distinctions between intra- and interLATA services are increasingly meaningless. Attempts to maintain the old distinctions by applying counterproductive safeguards such as the OI&M prohibition increase productions costs, harm incentives to make investments necessary to compete effectively, and ultimately deny consumers of the full benefits from innovative bundles of services at attractive prices that efficient competition can deliver.

I declare under penalty of perjury that the foregoing is true and correct. Executed on  
September 23, 2002.

  
Timothy J. Tardiff